

**STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA**

REPORT ON EXAMINATION

OF

ALFA MUTUAL FIRE INSURANCE COMPANY

Montgomery, Alabama

AS OF

DECEMBER 31, 2006

Participation:

ALABAMA
Southeastern Zone, NAIC

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AFFIDAVIT

**STATE OF ALABAMA
COUNTY OF MONTGOMERY**

Blase Francis Abreo, being first duly sworn, upon his oath deposes and says:

THAT he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

THAT an examination was made of the affairs and financial condition of *ALFA MUTUAL FIRE INSURANCE COMPANY*, for the period of January 1, 2002 through December 31, 2006;

THAT the following 44 pages constitute the report therein to the Commissioner of Insurance of the State of Alabama; and

THAT the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.

Francis Blase Abreo
Blase Francis Abreo, CFE

Subscribed and sworn to before the undersigned authority this 23rd day of May 2008.

Dianne B. Mills
(Signature of Notary Public)

Dianne B Mills Notary Public
(Print Name)

in and for the State of Alabama

My Commission expires 4-18-2009



BOB RILEY
GOVERNOR

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May 23, 2008

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Dear Commissioners and Directors:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a full scope financial and market conduct examination as of December 31, 2006, has been made of

ALFA MUTUAL FIRE INSURANCE COMPANY

at its home office at 2108 East South Boulevard, Montgomery, Alabama, 36116. The report of examination is submitted herewith. Where the description "Company" appears herein, without qualification, it will be understood to indicate Alfa Mutual Fire Insurance Company.

SCOPE OF EXAMINATION

A full scope financial and market conduct examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the *Alabama Insurance Code* and the regulations and bulletins of the State of Alabama Department of Insurance in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

The Company was last examined for the five-year period ended December 31, 2001. A limited scope examination for the period ended December 31, 2004, concluded on June 30, 2005. The current examination covers the intervening period from January 1, 2002, through December 31, 2006, and was conducted by examiners from the Alabama Department of Insurance. Where deemed appropriate, transactions subsequent to December 31, 2006, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2006. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the *Alabama Insurance Code* and the Insurance Department's rules and regulations, or other insurance laws or rules, or which were deemed by the examiner to require comments and/or recommendations.

The Company copies of the filed Annual Statements for the years 2002 through 2006 were compared with or reconciled to account balances with respect to ledger items.

The market conduct phase of the examination consisted of a review of the Company's territory, plan of operation, complaint handling, marketing and sales, producer licensing, policyholder service, underwriting and rating, claims payments and practices, and compliance with privacy policies and practices.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attests to having valid title to all assets and to the non-existence of unrecorded liabilities as of December 31, 2006. A signed letter of representation was also obtained at the conclusion of the examination

whereby management represented that, through the date of this examination report, complete disclosure was made to the examiners regarding asset and liability valuation, the financial position of the Company, and contingent liabilities.

ORGANIZATION AND HISTORY

The Company was incorporated May 1, 1945, under the name, Alabama Farm Bureau Mutual Insurance Services, Inc. It was organized as a mutual insurance company by the Alabama Farm Bureau Federation (AFBF), to provide fire and allied lines to the members of the AFBF.

Effective May 1, 1987, AFBF withdrew, as a franchise member, from the national Farm Bureau Federation and changed its name to Alabama Farmers Federation. The name of the Company was changed to Alfa Mutual Fire Insurance Company.

During the interim from the Company's organization through 1987, the Company became affiliated with four other property and casualty insurers. In 1987, a reinsurance pooling agreement was formed between these five affiliates. The terms of the agreement provide that all direct business of the affiliates will be ceded to Alfa Mutual Insurance Company (AMI). The pooled business is then retroceded according to percentages provided in the pooling agreement. In 1989, an intercompany reinsurance pooling committee, representing the Boards of Directors of the reinsurance pool participants, was established. This committee is responsible for reviewing and approving any changes to the pooling agreement, to assure that transactions are fair and equitable to all pool participants, and to monitor potential, or actual, conflicts of interest between pool participants.

In 1999, Alfa Specialty Insurance Corporation (ASI) was organized as a wholly-owned subsidiary of the Company. ASI became a participant in the reinsurance pooling agreement in 2001.

In 2004, Alfa Vision Insurance Corporation (AVI) was organized as a wholly-owned subsidiary of Alfa Corporation, an SEC registrant. Alfa Corporation is affiliated with Alfa Mutual Insurance Company, Alfa Mutual Fire Insurance Company, and Alfa Mutual General Insurance Company (collectively, the Mutual Group). The Mutual Group owns 54.8% of Alfa Corporation's common stock, their largest single investment. (See the heading SUBSEQUENT EVENTS for development on Alfa Corporation). AVI commenced business on January 1, 2005, and became a participant in the reinsurance pooling agreement effective January 1, 2005.

During the period covered by the examination, the Company amended the Articles of Incorporation by adding ARTICLE VIII, which was effective April 24, 2003, and amended Section II of the *By-Laws*, which was effective September 25, 2006.

MANAGEMENT AND CONTROL

Policyholders

The Company is a mutual insurance corporation with ownership vested in its policyholders. Membership in the Alabama Farmers Federation is a prerequisite for the purchase of insurance from the Company.

Board of Directors

According to Section III of the *By-Laws*, the corporate powers of the Company shall be vested in a Board of Directors consisting of eighteen directors. Directors are elected at the annual meeting of the general membership and serve until their successors are elected and qualified. The following directors were serving at December 31, 2006:

<u>Name and Residence</u>	<u>Principal Occupation</u>
Jerry Allen Newby Athens, Alabama	Chairman of the Board, President and CEO, Alfa Mutual Insurance Company
Jacob Calhoun Harper Camden, Alabama	Vice President, Southwest Area, Alfa Mutual Insurance Company
Richard Earl Saxon Attalla, Alabama	Farmer
David Eugene Bitto Elberta, Alabama	Farmer
Hal Franklin Lee Hartselle, Alabama	Vice President, North Area, Alfa Mutual Insurance Company
Stephen Leonard Dunn Evergreen, Alabama	Treasurer, Alfa Mutual Insurance Company
Luther Olen Bishop, Jr. Cherokee, Alabama	Farmer
William Larry King Guntersville, Alabama	Farmer
James Leo Allen Lisman, Alabama	Farmer

Jerry Houston Byrd Ariton, Alabama	Farmer
Russell Riley Wiggins Andalusia, Alabama	Vice President, Southeast Area, Alfa Mutual Insurance Company
John Guy Neighbors Alex City, Alabama	Farmer
John Elijah Walker Berry, Alabama	Farmer
James Louis Parnell Stanton, Alabama	Farmer
Curtis Dean Wysner Woodland, Alabama	Vice President, Central Area, Alfa Mutual Insurance Company
Stanley Ray Usery Athens, Alabama	Farmer
Doyle Leon Phillips Delta, Alabama	Farmer
Michael Wayne Dunn Union Springs, Alabama	Farmer

Officers

The Company's *By-Laws* provide that the principal officers shall be a Chairman of the Board, a President, four Vice Presidents, a Secretary, a Treasurer; and such other officers as the Board of Directors may determine for such terms, authority and duties as may be determined by the Board of Directors. One person may serve as both Chairman of the Board and President.

The following were elected officers at December 31, 2006:

Officer	Title
Jerry Allen Newby	Chairman of the Board, President and CEO
Stephen Leonard Dunn	Treasurer
Herman Alan Scott	Secretary
Clyde Lee Ellis III	Assistant Treasurer
Russell Riley Wiggins	Vice President, Southeast Area
Curtis Dean Wysner	Vice President, Central Area
Jacob Calhoun Harper	Vice President, Southwest Area
Hal Franklin Lee	Vice President, North Area

The following were appointed officers at December 31, 2006:

Officer	Title
Clyde Lee Ellis III	Executive Vice President, Operations
Herman Tyrone Watts	Executive Vice President, Marketing
Stephen Goddard Rutledge	Senior Vice President, CFO & Chief Investment Officer
Herman Alan Scott	Senior Vice President and General Counsel
James Alan Azar	Senior Vice President, Audit & Risk Management
John Thomas Jung	Senior Vice President, Chief Information Officer
Jerry William Johnson	Senior Vice President, Claims
Thomas Earle Bryant	Senior Vice President, Human Resources
Wyman Worley Cabaniss	Senior Vice President, P & C Underwriting
Carol Lynn Golsan	Senior Vice President, Marketing Services
Jerry Charles Ralph	Senior Vice President, Marketing, North Alabama
William Merit Hardy, Jr.	Senior Vice President, Marketing, South Alabama
Alfred Edwin Schellhorn	Vice President, Corporate Development
Linda Gail Pelt	Vice President, Auto Underwriting
Kenneth Everett Stephens	Vice President, P & C Systems Implementation
Elizabeth Vail Chancey	Vice President, Property & Casualty Underwriting
Ralph Clayton Forsythe	Vice President, Finance & Assistant CFO
David Ray Proctor	Vice President, Taxes
Gordon Thomas Carter	Vice President and Associate General Counsel
Donald Eugene Manis	Vice President, Property & Casualty Actuary
Christine Gnann Cantrell	Vice President, Marketing Communications
Connie Leah Whitecotton	Vice President, Chief Risk & Compliance Officer
Jacob Daniel Black	Vice President, P&C Accounting
Patti Jo Everage	Vice President, Financial Reporting & Planning
Russell John Sinco	Vice President, Projects, Finance
Douglas Wade Simpson	Regional Vice President, Claims
Harold Eugene Oakes	Regional Vice President, Claims
John Delane Hemmings Jr.	Vice President, Investments

Committees

The following committees were appointed by the Board of Directors and were serving at December 31, 2006:

<u>Executive Committee</u>	
Jerry Allen Newby	Curtis Dean Wysner
Hal Franklin Lee	Jacob Calhoun Harper
Russell Riley Wiggins	Stephen Leonard Dunn
<u>Contribution Committee</u>	
Hal Franklin Lee	Russell Riley Wiggins
Jacob Calhoun Harper	Curtis Dean Wysner
Stephen Leonard Dunn	
<u>Pooling Committee</u>	
Jerry Allen Newby	John Elijah Walker
David Eugene Bitto	

Conflict of Interest

The Company follows an established procedure for the disclosure of conflicts between the Company's interest and the personal interest of directors and officers. The conflict of interest policy is part of the "Principles of Business Conduct" (Principles) policy, which was effective August 14, 2001. Effective February 4, 2003, the Principles went into major revision, when the Company incorporated the provisions required by the Federal Sarbanes-Oxley Act.

Section 8 of the revised Principles, does not require the employees to sign annual conflict of interest statements. Under the policy, all new employees are required to confirm their compliance with the policy at their hiring. Confirmations are obtained from all existing employees when the policy undergoes significant revision, or whenever circumstances dictate that reconfirmation would be helpful in reinforcing the Company's "tone at the top" message.

The listing that indicated that the officers and directors had read the Principles and electronically acknowledged that they had read the Principles was reviewed. The disclosures made during the period did not appear to represent a conflict of interest. The listing was checked with the names of the officers and directors listed on the Company's Annual Statements under examination. The review indicated that some directors and some elected officers, all of which were non-employees, had not acknowledged reading the Principles, since it had a significant revision, effective

February 4, 2003. Company management indicated that the aforementioned directors and elected officers had signed the acknowledgement, confirming reading and adhering to the Principles, since its significant revision. However, according to Company management, the signed copies had been misplaced and could not be located.

The Company indicated “Yes” to the GENERAL INTERROGATORIES of the NAIC Annual Statement Instructions, which asks the following question:

“Has the reporting entity an established procedure for disclosure to its board of directors or trustees of any material interest or affiliation on the part of any of its officers, directors, trustees, or responsible employees that is in conflict or likely to conflict with the official duties of such persons?”

As noted above, the Company had an established procedure for the disclosure of conflicts of interest to the Board of Directors; however, the Company could not provide evidence that all directors and officers had signed the conflict of interest statements.

CORPORATE RECORDS

The Articles of Incorporation, and *By-Laws*, as amended were inspected and found to provide for the operation of the Company in accordance with usual corporate and applicable statutes and regulations.

Minutes of the Annual Membership meetings, Board of Directors and committees of the Company, from January 1, 2002, through the most recent meetings recorded at the time of examination, were reviewed.

HOLDING COMPANY AND AFFILIATES

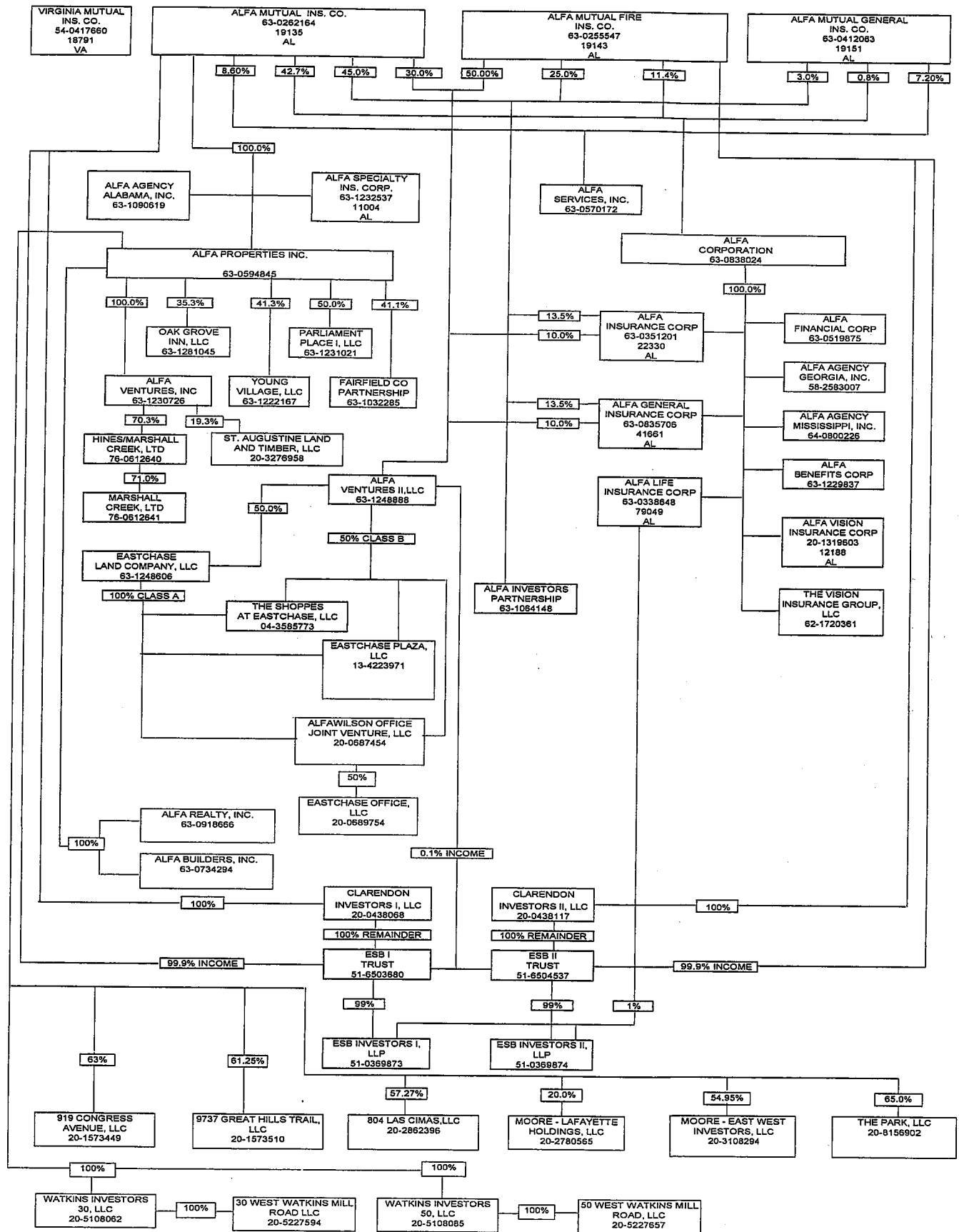
Holding Company Registration and Reporting

The Company is subject to the *Alabama Insurance Holding Company Regulatory Act*, as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company is registered with the Alabama Department of Insurance as joint registrant of an Insurance Holding Company System. The Company is responsible for holding company registration and periodic filings in accordance with ALA. CODE § 27-29-4 (1975), and ALA. ADMIN. CODE 482-1-055 (1994).

Appropriate filings required under the Holding Company Act were made from time to time by the Company as registrant. The examination did not determine that any required disclosures were excluded from the Company's filings, except as noted under the caption *Monthly Billing Service Agreement*.

Organizational Chart

The following Chart presents the identities and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2006.



Transactions and Agreements with Affiliates

Management and Operating Agreement

The following insurers were under the control of Alfa Mutual Insurance Company (AMI) and were parties to a Management and Operating Agreement with AMI: 1) The Company; 2) Alfa Mutual General Insurance Company; 3) Alfa General Insurance Corporation; 4) Alfa Insurance Corporation; 5) Alfa Specialty Insurance Corporation; 6) Alfa Life Insurance Corporation; and 7) Alfa Vision Insurance Corporation. These companies will be referred to, collectively as the "affiliates" in the remainder of the discussion of this topic.

The original agreement had been in effect since January 1, 1960, with periodic amendments to modify the terms and to add companies as they became affiliated. Effective January 1, 2001, it was amended and restated "...in its entirety in order to clarify and make more certain their relationship to one another." Also, the term of the agreement was to be five years, through December 31, 2005, then automatically renewed for periods of one year. Effective January 1, 2005, it was amended to include Alfa Vision Insurance Corporation.

Pertinent terms of the agreement include the following:

- The affiliates appoint and engage AMI to take charge of, conduct, operate and manage the business operations of the affiliates, respective to each affiliate's charter and Board of Directors, and in a proper and prudent fashion. AMI will provide all home office operating service to the affiliates, including accounting, disbursement and payroll services and will serve as a disbursing agent for the payment of all employees and agents of the affiliates.
- AMI agrees to employ, in its own name, all personnel necessary to perform the aforesaid, and reserves all rights and responsibilities of the employer of said personnel. All agents of the affiliates shall be appointed in the name of the respective affiliates and shall work on behalf of the respective affiliates. All personnel and agents of any affiliate employed outside Alabama are the sole responsibility of that affiliate. AMI agrees to indemnify and hold the affiliates harmless against any loss on account of the dishonesty or infidelity of any of AMI's employees. Also, the affiliates agree to indemnify and hold harmless AMI for liabilities and obligations prior to the effective date of the agreement, failure or negligent failure of the affiliate to perform under the agreement, breach of

warranty by the affiliate and liabilities or obligations of AMI's management or operation of the affiliate.

- AMI agrees that the business of each party to the agreement shall be conducted in the name of the respective party and that the records of each party shall be kept separately. AMI agrees to provide all required records, record-keeping services and data processing necessary to the efficient and economical operation of such business.
- The affiliates agree to reimburse AMI for expenses and additional charges in accordance with schedules which are attached to the agreement. These schedules are subject to periodic amendment. Expense allocations and other charges are determined by time, usage, and related special expense allocation studies conducted by AMI. Expenses entirely attributable to the affiliates such as printing and supplies are purchased and paid for directly by the respective affiliate.
- Arbitration: Disputes not resolved in 30 days are to be submitted for arbitration in the Birmingham, Alabama, office of the American Arbitration Association in accordance with commercial arbitration rules.
- Confidentiality: Each party agrees to keep all Confidential Information strictly confidential.

Numerous expense categories are prorated between affiliates on Schedule A, an attachment to the agreement. Certain other expenses are allocated directly to the affiliates that benefit from expenditures. Agents' commissions are allocated 100% to the affiliate writing the business. Fixed monthly charges are paid by the affiliate for certain other expenses.

Monthly Billing Service Agreement

The Company entered into a Monthly Billing Service Agreement between Alfa Financial Corporation (Financial) and: 1) The Company, 2) Alfa Mutual General Insurance Company, 3) Alfa Mutual Insurance Company, 4) Alfa Insurance Corporation, and 5) Alfa General Insurance Corporation (collectively referred to as "Insurers"). The agreement was effective January 1, 2005, and included the following:

- Financial agreed to grant a perpetual nontransferable license to use Financial's software in order to process transactions.

- Insurers will pay to Financial a non-refundable processing fee for the right to use Financial's software for processing monthly premium payment transactions.
- Financial will bear all credit losses.
- Financial shall be obligated to provide the software to Insurers without further charge or obligation and to provide Insurers any and all updates to said software.
- Insurers will remit to Financial the service fees no less frequently than on a monthly basis.
- The contract may be cancelled by either party by giving to the other party notice of cancellation in writing thirty days prior to the date cancellation is to become effective.
- In the event of cancellation, Insurers have no further right to use Financial's software, and Insurer's shall pay Financial through the date of cancellation.
- The contract will be governed by Alabama Law.
- The contract can only be amended in writing signed by all the parties.

A review of the aforementioned *Monthly Billing Service Agreement* and the holding company filings and amendments made on behalf of the Company indicated that the agreement had not been approved by the Alabama Department of Insurance. Because the Company had not obtained approval of the agreement among affiliates within the holding company system, the Company was not in compliance with ALA. CODE § 27-29-5 (b) (1975), which states:

“The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. . . .

(4) All management agreements, service contracts, and all cost-sharing arrangements; and. . . .”

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2006, the Company was named insured under a financial institution bond issued by Fidelity and Deposit Company of Baltimore, Maryland. The single loss limit of the bond met the NAIC suggested minimum requirements for fidelity coverage. The bond provided the following coverages:

- Fidelity
- Forgery or alteration
- Optional
 - Agents # 1
 - Computer systems fraud.

The Fidelity coverage insured the Company against any loss through any dishonest or fraudulent act committed by an employee acting alone or in collusion with others. The dishonest or fraudulent acts must be committed by the employee with the manifest intent to cause the insured to sustain such loss and to obtain financial benefit in the normal course of employment.

In addition to the fidelity bond, Alfa Mutual Insurance Company maintained other insurance policies to protect the Company and its affiliates against hazards to which they may be exposed.

EMPLOYEES' AND AGENTS' WELFARE

The Company had no employees; therefore, it had no formal employees' or agents' welfare program. Its operations were conducted by the personnel of Alfa Mutual Insurance Company, an ultimate parent of the Company, under the terms of a Management and Operating Agreement. The Company's officers, elected and appointed, for the Company were also employees of Alfa Mutual Insurance Company. For further comment, see the caption *Management and Operating Agreement* under the heading HOLDING COMPANY AND AFFILIATES.

Section 1033 of Title 18 of the U.S. CODE

As noted above, the Company's operations were conducted by personnel employed by Alfa Mutual Insurance Company (AMI) under the terms of a Management and Operating Agreement. According to ALA. ADMIN. CODE 482-1-121 (2003), persons who act as or are officers, directors, producers, or employees, including those

authorized to act on their behalf are subject to Section 1033 of Title 18 of the U.S. CODE; therefore the Company and those acting on its behalf including Directors, officers, agents, and employees working under the terms of a Management and Operating Agreement are subject to the terms of the aforementioned ALA. ADMIN. CODE.

The Company was asked how it determined if those working on its behalf were not in conflict with Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which prohibits certain persons from participating in the business of insurance.

The Company provided an employment application used during the examination period which asks potential employees about any criminal convictions during the previous ten years and the authorization to obtain consumer and/or investigative consumer reports on the applicant. Company management indicated that the Company does not hire applicants who have been convicted of a felony unless prior authorization has been obtained from the Alabama Department of Insurance in accordance with ALA. ADMIN. CODE 482-1-121 (2003). The Company's "Principles of Business Conduct" (Principles) policy requires that employees report any felony convictions, either personal or about another employee immediately to Human Resources.

Although, the employment applications used during the examination period, asked potential employees about felony convictions within the last ten years, and the Principles policy requires employees to report felony convictions, the Company could not demonstrate that employees who had been with the Company before the Principles went into effect were not in conflict with ALA. ADMIN. CODE 482-1-121 (2003), which states:

"... The Act contains no grandfather provision for persons already transacting the business of insurance. The Act contains no automatic waivers for individuals who may possess a state insurance license. Further, there is no time limitation on how far back the felony conviction that triggers the prohibited person status may have occurred. ..."

The Company indicated it had a procedure in place to perform background checks on agents and customer service representatives since 1998, and on its home office employees since 2004. The Company provided evidence that in 2003-2004 its employees electronically certified pursuant to the Company's Principles policy that they had not been convicted of a felony and would inform management of any

changes to their responses. According to the Company, employees hired subsequent to 2004 signed the policy when hired and a copy is maintained in their personnel file.

The Company could not provide evidence that it had a policy in place to ensure those authorized to act on its behalf continued to meet the requirements of Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which states:

“ . . . Insurance companies, as well as persons employing anyone to conduct the business of insurance may be in violation of this statute if they willfully permit participation by a prohibited person, including persons who are already employed or being considered for employment. Failure to initiate a screening process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statute has occurred. . . .”

MARKET CONDUCT ACTIVITIES

Territory

At December 31, 2006, the Company was licensed to transact business in the following states:

Alabama

Illinois

Virginia

North Carolina

The Certificates of Authority from the respective jurisdictions were inspected and found to be in effect at December 31, 2006.

Plan of Operation

The Company markets its products through captive agents. At December 31, 2006, the Company had 262 services centers in Alabama, with 486 agents appointed to write its business. The Company did not write business outside Alabama during the examination period, although it was licensed in three other states.

For the year 2006, direct premiums written for fire insurance comprised 70% of the Company's total business. Another 25% was comprised of allied lines insurance. The remaining 5% was comprised of inland marine insurance.

Policy Forms and Underwriting

All the Company's active policy forms and rates in force at December 31, 2006, were found to have been approved by the Alabama Department of Insurance. Rates were filed independently on the Company's direct business.

Membership in the Alabama Farmers Federation was a prerequisite to the issuance of a policy with the Company. The Company's policy is to cancel coverage when Federation membership is not renewed, except on those policies involving a real property lien holder.

Compliance with Agents' Licensing Requirements

In order to verify compliance with agents' licensing requirements of the Alabama Department of Insurance (ALDOI), a sample of fifty agents licensed in Alabama was taken from the listing maintained by the Company. The agents' names were compared with the listing maintained on the ALDOI website. No discrepancies were found within the sample.

A sample of 100 policies written by the Alfa P & C companies in the State of Alabama was checked against the ALDOI's licensing records, to verify if the agents were appropriately licensed for the P & C Companies. No discrepancies were found within the sample.

Advertising and Marketing

The Company's advertising materials were reviewed for the period covered by the examination. The advertisements consisted of signs, billboards, newspaper advertisements and spot advertisements on radio and television.

The Company's web page (www.alfains.com) was reviewed and found to include the following links: Company's background, product lines, claim information, career opportunities, how to locate an agent or the Alabama Farmers Federation, headlines, and Company contact information.

The Company's advertising was planned and coordinated by Integrated Marketing Communication, a subdivision of the Alfa Mutual Insurance Company's marketing division. The cost of advertisement was shared on a proportionate basis with other participating affiliates of the Company and the Alabama Farmers Federation. Company management indicated that the producers are not allowed to create their

own advertising and sales material, including internet sites. Producers are required to use Company approved advertising material.

Claims Payments Practices

Paid Claims

A sample of one hundred claims was selected from the 2002 – 2006 closed claim register. The population from which the sample was taken included all of the paid claims from each of the P&C companies being examined. The paid claims sample was reviewed with regards to compliance with policy provisions, timeliness of payments, and adequacy of documentation. Other than the items listed below, no noteworthy discrepancies were found within the sample of paid claims. The examiners determined the following:

- Five files could not be located.
- Two claim payment drafts could not be located.

Since the Company could not provide the five files and the two claim payment drafts, the Company did not comply with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

Denied and Closed without Payment Claims

A sample of one hundred claims was selected from a population of 120,941 claims denied during the examination period. The population from which the sample was taken included all of the denied claims from each of the P&C companies being examined. The claims were reviewed to verify compliance with claims payment practices of the Alabama Department of Insurance (ALDOI). The examiners determined the following:

- Two files could not be located.
- Four files did not have denial notifications to the insured, but had a note indicating that the files were closed.
- Two files did not have any correspondence.

Since the two files could not be located and six other files lacked adequate denial correspondence, the Company was not in compliance with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

Because six of the eight files did not contain documentation regarding the denial notification, the Company was not in compliance with ALA. ADMIN. CODE 482-1-125-.07 (1) (2003), which states:

“... No insurer shall deny a first party claim on the grounds of a specific policy provision, condition or exclusion unless reference to such provision, condition, or exclusion is included in the denial. The denial may be given to the first party claimant in writing, verbally or electronically (e-mail). If verbal, the file should clearly indicate the denial and reasons for the denial. If the denial is in writing or electronic (e-mail), the file should contain a copy of the denial letter or e-mail. ...”

Company management response concerning two of the missing files:

[While we make every effort to retain all claim files, we do acknowledge that one of the two files has not been located at this time. We are continuing to locate this file. One of the two files, with a closed date of 2/26/2002, falls outside the required retention period as required by ALA. ADMIN. CODE §482-1-125-.04 (a), which states:

“This data must be available for all open and closed files for the current year and the five (5) preceding years, in order to permit reconstruction of the insurer’s activities relative to each claim.”]

Company management response concerning the six files with missing correspondence:

[Alfa’s claim Management has reviewed six of the eight files and found no evidence that these claims were denied on the grounds of a specific policy provision, condition or exclusion. Also, the Company’s Best Practices Manual

states, "The claim file needs to be documented in such a fashion that the reasoning behind a denial can be clearly understood by other claims professional."]

Policyholders' Complaints

The Company's complaint register was reviewed in order to verify if all written complaints were logged on the register. Company management indicated that complaints from insurance departments and written complaints received at the home office that allege violation of state or federal laws or of any regulations, directives, or bulletins of the insurance departments are logged on the register. There was one register for the seven Alfa P&C Companies combined, which included: 1) The Company, 2) Alfa Mutual Insurance Company, 3) Alfa Mutual General Insurance Company, 4) Alfa Insurance Corporation, 5) Alfa General Insurance Corporation, 6) Alfa Specialty Insurance Corporation, and 7) Alfa Vision Insurance Corporation.

During the period covered by the examination, 233 complaints were logged on the register against the Alfa P & C Companies. The complaint register did not specify which company was the subject of the complaint. Fifty complaint files were requested to determine if the files contained adequate documentation. The examiners determined that the Alfa P & C companies maintained adequate documentation.

The Alabama Department of Insurance adopted the NAIC Market Regulation Handbook, effective May 7, 2007, via ALA. ADMIN. CODE 482-1-097-.07 (2007). According to the handbook, regulated entities should include, but not be limited, to the following information in the complaint register:

- Line of business
- Function (underwriting, marketing and sales, claims, policyholder services or miscellaneous);
- Reason for complaint (underwriting, application, cancellation, rescission, non-renewal).

The handbook also requires that the regulated entity record all written communication expressing a grievance in the regulated entity's complaint register.

Privacy Policies and Practices

The Company's policy is that non-public information involving underwriting, marketing, claims handling, and fraud prevention is not shared with anyone outside

the Company except for that sharing allowed by the exceptions in the Gramm-Leach-Bliley Act. The insured receives a Privacy Notice at the point-of-sale, and the Company sends a Privacy Notice to the insured on an annual basis. The Company complied with the privacy requirements of ALA. ADMIN. CODE 482-1-122 (2001).

SPECIAL DEPOSITS

In order to comply with the statutory requirements for doing business in the various jurisdictions, in which it was licensed, the Company had the following securities on deposit with state authorities at December 31, 2006.

<u>State</u>	<u>Book Value</u>	<u>Fair Value</u>
Alabama	\$124,766	\$126,748
Virginia	297,401	299,613
Total	\$422,167	\$426,361

FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

<u>Year</u>	<u>Gross Premiums Written</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Policyholders' Surplus</u>
2001*	\$143,039,257	\$684,159,065	\$120,685,485	\$563,473,580
2002	158,007,918	710,492,664	125,639,369	584,853,295
2003	176,965,385	793,849,837	168,998,795	624,851,042
2004	185,454,398	785,071,624	176,315,485	608,756,139
2005	210,587,011	764,025,875	173,962,677	590,063,198
2006*	240,230,301	773,902,701	155,319,476	618,583,225

*Per examination.

Amounts for the remaining years were obtained from Company copies of filed Annual Statements.

REINSURANCE

Intercompany Reinsurance Pooling Agreement

This agreement was originally effective August 1, 1987, between the Company and its affiliates: Alfa Mutual Insurance Company (AMI); Alfa Mutual General Insurance Company (AMG); Alfa General Insurance Company (AGI); and Alfa Insurance

Corporation (AIC). Alfa Specialty Insurance Corporation (ASI) was added to the pool in 2001. Alfa Vision Insurance Corporation (AVI) was added to the pool in 2005. These participants in the pooling agreement will be referred to as “the affiliates” for the remainder of this discussion. This reinsurance pooling agreement was filed with the Alabama Department of Insurance on July 29, 1987, and was subsequently approved. Pertinent terms of the agreement are as follows:

Initially, the affiliates ceded 100% of their book of business, then in-force, to the Alfa Mutual Insurance Company (AMI) and paid AMI their proportionate share of the net unearned premium less commissions at the provisional rate of 20%.

Currently, the affiliates cede 100% of the net liabilities for net premiums written to AMI. AMI retains or retrocedes the pooled business in accordance with the following percentages:

Company	Effective January 1, 2001	Effective January 1, 2005
AMI	18	18
AMF	13	13
AMG	3	3
ASI	1	1
AIC	32.5	30
AGI	32.5	30
AVI	N/A	5
TOTAL	<u>100</u>	<u>100</u>

The following percentages are shown below for the Coinsurance Allocations for Catastrophe Losses and Related Expenses for the related years:

Effective January 1, 2002			Effective January 1, 2003		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation		Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI AIC	AMI, AMF AMG, ASI		AGI AIC	AMI, AMF AMG, ASI
11.6	65%	35%	12.125	65%	35%
19	0%	100%	19	0%	100%
32	0%	100%	32	0%	100%
43	0%	100%	43	0%	100%
77	0%	100%	77	0%	100%
146	0%	100%	146	0%	100%
198	0%	100%	198	0%	100%
289+	16%	84%	301.5 +	18%	82%

- Cumulative calendar year catastrophe losses and related expenses are in millions.
- AIC and AGI to be allocated equally.
- AMI, AMF, AMG, and ASI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC and AGI to be allocated according to this group's relative surplus.

Effective January 1, 2004		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI AIC	AMI, AMF AMG, ASI
Less than or = 14.2	65%	35%
Between 14.2 - 352	0%	100%
Greater than or = 352	18%	82%

- AIC and AGI to be allocated equally.
- AMI, AMF, AMG, and ASI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC and AGI to be allocated according to this group's relative surplus.

Effective January 1, 2005			Effective January 1, 2006		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation		Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI, AVI AIC	AMI, AMF AMG, ASI		AGI AVI AIC	AMI, AMF AMG, ASI
Less than or = 17.9	65%	35%	Less than or = 21.2	65%	35%
Between 17.9 – 443.7	0%	100%	Between 21.2 – 525.5	0%	100%
Greater than or = 443.7	19%	81%	Greater than or = 525.5	21%	79%

- AMI, AMF, AMG, ASI, AIC, AGI and AVI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC, AGI and AVI to be allocated according to this group's relative surplus as reported in the preceding year-end annual statement.

- Effective January 1, 2006 - Coinsurance Allocation of AMI to include any coinsurance allocation for ASI (AMI's wholly owned subsidiary).

Reinsurance Assumed

At December 31, 2006, the Company had a Quota Share Reinsurance Treaty with Virginia Mutual Insurance Company (VMI), an affiliate, effective August 10, 2001, whereby the Company assumed 80% of VMI's net retained liability of each and every insurance policy, binder or contract in-force on or after the effective date of the agreement. VMI retained the remaining 20%. (The 80% then becomes subject to pooling, whereby a percentage of earned premiums is then retroceded to General Reinsurance Corporation. See Reinsurance Ceded, Contract 9168.)

At December 31, 2006, the Company assumed reinsurance from the intercompany pool via the following three contracts:

- 1) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective January 1, 2006, whereby the Company assumes 100% of the First and Second Excess Catastrophe Reinsurance.

	First Excess	Second Excess
Company's Retention	\$75,000,000	\$125,000,000
Participation Rate:		
AMI	54.3%	54.3%
AMG	8.6%	8.6%
AIC	0%	0%
AGI	0%	0%
AVI	0%	0%
AMF	37.1%	37.1%
Reinsurer's Per Occurrence Limit (100% of)	\$50,000,000	\$75,000,000
Reinsurer's Term Limit (100% of)	\$100,000,000	\$150,000,000

- 2) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective June 1, 2006, whereby the Company assumes 100% of the Third, Fourth, Fifth, Sixth A and Sixth B Excess Catastrophe Reinsurance, subject to the following:

	Third Excess	Fourth Excess	Fifth Excess	Sixth A Excess	Sixth B Excess
Company's Retention	\$200,000,000	\$300,000,000	\$400,000,000	\$500,000,000	\$525,500,000
Intercompany Placement %	72.25%	96.3%	85.925%	79.555%	79.555%
Participant Rate:					
AMI	54.3%	54.3%	54.3%	54.3%	46.3%
AMG	8.6%	8.6%	8.6%	8.6%	2.1%
AIC	0%	0%	0%	0%	9.8%
AGI	0%	0%	0%	0%	10.1%
AVI	0%	0%	0%	0%	1.2%
AMF	37.1%	37.1%	37.1%	37.1%	30.5%
Per Occurrence Limit (100% of)	\$100,000,000	\$100,000,000	\$100,000,000	\$25,500,000	\$174,500,000
Reinsurer's Term Limit (100% of)	\$200,000,000	\$200,000,000	\$200,000,000	\$51,000,000	\$349,000,000

- 3) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective June 15, 2006, whereby the Company assumes 100% of the Seventh Excess Catastrophe Reinsurance. The Company's pool participation rate for this layer is 20.5%. The Company's retention is the first \$700,000,000 of ultimate net loss per occurrence, with a term limit of 80.5% of \$100,000,000.

At December 31, 2006, the Company also had two active contracts for reinsurance assumed (outside the intercompany reinsurance pool):

- 1) Renaissance Reinsurance Ltd. – This Catastrophe Portfolio Participation Reinsurance contract was effective January 1, 2006, and reinsured losses payable amounting to \$1,443,000 at December 31, 2006. This amount is less than materiality for examination purposes.
- 2) Faraday Underwriting Ltd. Syndicate 435 – This Quota Share Treaty was effective January 1, 2006, whereby the Company assumed 9% of Faraday's Assumed World Wide Catastrophe Risk. Reinsured reserves amounted to \$7,512,000 at December 31, 2006, which was less than materiality for examination purposes.

Reinsurance Ceded

As of December 31, 2006, the following contracts for ceding reinsurance to non-affiliated companies were applicable to the Company:

General Reinsurance Corporation

- Excess of Loss Reinsurance (9138) – effective April 1, 2004, on property business. The Company's retention for the first excess cover was \$500,000 and the second excess cover was \$1,000,000. The limit of liability of the reinsurer will not exceed a total payment of net loss and adjustment expense combined under the first excess cover of \$1,500,000 or under the second excess of \$3,000,000 all risks involved in one occurrence. This agreement also included excess of loss reinsurance of liability business. The Company's retention was \$500,000 for the first excess cover and \$1,000,000 for the second excess cover. Effective July 1, 2006, the Company's retention for the first excess cover increased to \$750,000 and a third excess cover in the amount of \$2,000,000 for new and renewal policies becoming effective at and after October 1, 2006, was added.
- Excess of Loss Reinsurance of Virginia Mutual Property Business (9168) – effective January 1, 2005. Applies to the 80% assumption by the Company of commercial auto no-fault (personal injury protection), other commercial auto liability (including uninsured and underinsured motorists), other liability, commercial multiple peril (liability coverages), homeowners multiple peril (liability coverages) and farmowners multiple peril (liability coverages) written by Virginia Mutual Insurance Company. The Company's retention for the first and second excess cover was \$500,000. The limit of liability of the reinsurer was \$500,000 for the first excess cover and \$1,000,000 for the second excess cover.
- Excess of Loss Reinsurance of Virginia Mutual Property Business (9168) – effective January 1, 2005. Applies to the 80% assumption by the Company of fire, allied lines, inland marine, commercial multiple peril (property coverages), homeowners multiple peril (property coverages), and farmowners multiple peril (property coverages) written by Virginia Mutual Insurance Company. The Company's retention for the first and second excess cover was \$500,000. The limit of liability of the reinsurer was \$500,000 for the first excess cover and \$1,000,000 for the second excess cover. The liability of the reinsurer shall not exceed \$1,500,000 under the first excess cover nor \$2,000,000 under the second excess cover with respect to all net loss and adjustment expenses combined on all risks involved in one occurrence.

Lloyd's of London and ACE Tempest Reinsurance Ltd. - Traditional Excess Catastrophe Reinsurance Contract effective January 1, 2006 (1st and 2nd Layers), June 1, 2006 (3rd – 6th Layers) and June 15, 2006 (7th Layer) on fire and allied lines, inland marine and the property perils only of homeowners, mobile homeowners,

farmowners and commercial multiple peril (including business owners and church business).

Lloyd's of London was the leading company with other various authorized and unauthorized U.S. and alien reinsurers under this contract with 17.6% participation in the First Excess Layer, 14.85% participation in the Second Excess Layer, 6.25% participation in the Third Excess Layer, 14.55% participation in the Fourth Excess Layer, 14.85% participation in the Fifth Excess Layer, 9.255% participation in the Sixth Excess Layer and 25.25% participation in the Seventh Excess Layer.

ACE Tempest Reinsurance Ltd. had 5% participation in the First and Second Excess Layers, 10% participation in the Third Excess Layer, 10% participation in the Fourth Excess Layer, 10% participation in the Fifth Excess Layer, 5% participation in the Sixth Excess Layer and 7.5% in the Seventh Excess Layer.

Retention and limits were as follows:

- As respects each excess layer of reinsurance coverage provided by this contract, the Company shall retain and be liable for the first amount of ultimate net loss, shown in the table below as the Company's retention for that excess layer, arising out of each loss occurrence. The reinsurer shall then be liable, as respects each excess layer, for the amount by which such ultimate net loss exceeds the Company's applicable retention, but the liability of the reinsurer under each excess layer shall not exceed the amount (shown as reinsurer's per occurrence limit below) as respects any one loss occurrence.
- The Company shall retain a 5.0% part of a 100% share in the interests and liability of the "reinsurer" under this contract.
- The Company shall be permitted to carry excess catastrophe reinsurance, recoveries under which shall inure solely to the benefit of the Company and be entirely disregarded in applying all of the provisions of this contract.
- As respects any one loss occurrence involving loss in excess of policy limits and/or extra contractual obligations awards, this contract shall not apply to such loss in excess of policy limits and/or extra contractual obligations unless the loss occurrence involves two or more risks insured by the Company.

	First Excess	Second Excess	Third Excess	Fourth Excess	Fifth Excess	Sixth Excess	Seventh Excess
Company's Retention	\$75M	\$125M	\$200M	\$300M	\$400M	\$500M	\$700M
Reinsurer's per Occurrence Limit	\$50M	\$75M	\$100M	\$100M	\$100M	\$200M	\$100M
Reinsurer's Annual Limit	\$100M	\$150M	\$200M	\$200M	\$200M	\$400M	\$200M

Multiple-Year Traditional Excess Catastrophe Reinsurance Contract – effective January, 2005, on fire, allied lines, inland marine and the property peril only of homeowners, mobile homeowners, farmowners and commercial multiple peril. AMF's retention was \$75 million, with a maximum liability of \$125 million.

DaVinci Reinsurance Ltd. accepted a 7.5% share and Renaissance Reinsurance, Ltd. accepted a 17.5% share in the interests and liabilities of the reinsurer.

All of the contracts for ceded reinsurance contained the usual insolvency clause, which provides for payments to a receiver or statutory successor without diminution, in the event of the insolvency of the ceding company.

ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained on electronic data processing equipment. Management and record-keeping functions were performed by the personnel of Alfa Mutual Insurance Company under a Management and Operating Agreement. For further review of the agreement, see the caption *Management and Operating Agreement* under the heading HOLDING COMPANY AND AFFILIATES.

The examiners reviewed the accounts and records maintained by the Company for its cash disbursements of \$25.00 or more. The review indicated the Company's documentation for intercompany balance transfers was not in compliance with ALA. CODE § 27-27-30 (1975). The Company provided copies of the cancelled checks, and vouchers which included the amount of transfer, the payor, and payee. The documentation did not include a description of the consideration for the payment, a description of the services provided, itemization of the expenditures, or a

receipt. The documentation is required by ALA. CODE § 27-27-30 (1975), which states:

“(a) No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money.

(b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. . . .”

Internal Accounting Records

The Company's internal controls and information systems are those of AMI, since the Company is operated by AMI, in accordance with the aforementioned Management and Operating Agreement. Said internal controls and information systems were reviewed during the concurrent examination of AMI. They were evaluated by observation, interviewing AMI personnel, and reviewing the NAIC Internal Controls and Information Systems Questionnaires, and Examiner Planning Questionnaire completed by AMI. AMI's internal controls and information system controls appeared to be sufficient to safeguard the Company's assets and to generate adequate records of its business. The Company's accounting systems and documentation of its transactions were deemed adequate.

External Audit and Actuarial

The Company and its affiliates were audited annually, on a statutory basis. In 2006, the Company and its affiliates were audited by the certified public accounting (CPA) firm of PriceWaterhouseCoopers (PwC), Birmingham, AL; and annually in 2002-2005 by KPMG, Birmingham, AL. The audit reports and workpapers of the external auditors were made available to the examiners, and were utilized as deemed appropriate.

The Company's reserves were certified as of December 31, 2002, 2003, 2004, and 2005, by Mr. Scott Weinstein, FCAS, MAAA, of KPMG, LLC. The Company's reserves were certified as of December 31, 2006, by Mr. Anthony Kellner, FCAS, MAAA, of PwC.

Record Retention Policy

The Company's Record Retention Policy stated that the Company maintains its records as required by law and as long as the records were useful to the Company. Company management also indicated that each department within the Company is responsible for developing a record retention schedule that meets the specific needs of the department. The examination determined that the Company's record retention policy did not contain specific language as to the actual length or time the records are to be retained in accordance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer . . . or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer's financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

Disaster Recovery Plan

The NAIC Information System Questionnaire (ISQ) assisted the examiners in determining the strengths and weaknesses within the Company's IS Department. Based on a review of the ISQ responses and supporting documentation, it was determined the business continuity plan describes senior management's roles and responsibilities associated with the declaration of an emergency and implementation of the disaster recovery and business continuity plans.

The Company provided a copy of its Disaster Recovery Plan and documentation supporting its testing. The Company's ISQ responses, Disaster Recovery Plan and supporting documentation were reviewed and it was determined the Company has an adequate and up-to-date plan in place. The plan is reviewed quarterly and tested annually at an alternate site.

Consideration of Fraud

The examiners utilized the procedures recommended in the NAIC Financial Condition Examiners Handbook in Exhibit M – Consideration of Fraud. The CPA documentation on the fraud risk factors was reviewed and procedures were included during the examination to test the risk factors identified during the planning stages of the examination. Company management was interviewed; management showed an

understanding of the fraud risk factors in the Company and has taken action over the years to mitigate the risk.

FINANCIAL STATEMENTS

The Financial Statements included in this report were prepared based on the Company's records and the valuations and determinations made during the examination for the year ended December 31, 2006. Amounts shown in the comparative statements for the years 2002, 2003, 2004, and 2005, were compiled from the Company copies of filed Annual Statements. The statements are presented in the following order:

Statement of Assets, Liabilities, Surplus	33 and 34
Summary of Operations	35
Capital and Surplus	36

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.**

ALFA MUTUAL FIRE INSURANCE COMPANY
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS

For the Year Ended December 31, 2006

	Assets	Non-admitted Assets	Net Admitted Assets
<u>ASSETS</u>			
Bonds	\$374,109,693	\$ 0	\$374,109,693
Stocks:			
Preferred Stock	9,095,760	0	9,095,760
Common Stock	202,770,962	0	202,770,962
Properties held for the production of income less encumbrances (Note 1)	12,287,840	0	12,287,840
Properties held for sale less encumbrances	525,859	0	525,859
Cash, cash equivalents, and short-term investments	56,347,655	0	56,347,655
Other invested assets	64,910,253	2,746,142	62,164,111
Receivables for securities	47,705	0	47,705
Subtotals, cash and invested assets	\$720,095,727	\$2,746,142	\$717,349,585
Investment income due and accrued	4,163,373	8,511	4,154,862
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection (Note 2)	28,497,668	24,259	28,473,409
Deferred premiums, agents' balances and installments booked but deferred and not yet due (Note 2)	14,321,939	5,028	14,316,911
Reinsurance:			
Amounts recoverable from reinsurers	2,533,040	440,351	2,092,689
Current federal and foreign income tax recoverable and interest Thereon	2,199,247	0	2,199,247
Guaranty funds receivable or on deposit	8,736	0	8,736
Receivables from parent, subsidiaries and affiliates	5,301,549		5,301,549
Health care and other amounts receivable	6,186	473	5,713
Aggregate write-ins for other than invested assets	360,964	360,964	0
TOTAL	<u>\$777,488,429</u>	<u>\$3,585,728</u>	<u>\$773,902,701</u>

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF**

ALFA MUTUAL FIRE INSURANCE COMPANY
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS

For the Year Ended December 31, 2006

LIABILITIES:	
Losses	\$47,681,868
Reinsurance payable on paid losses and loss adjustment expenses	9,405,249
Loss adjustment expenses	5,722,089
Commissions payable, contingent commissions and other similar charges	5,703,264
Other expenses (excluding taxes, licenses, and fees)	2,186,743
Taxes, licenses, and fees (excluding federal and foreign income taxes)	21,262
Net deferred tax liability	15,664,143
Unearned premiums	43,765,963
Advance premium	7,026,130
Ceded reinsurance premiums payable (net of ceding commissions)	1,439,198
Amounts withheld or retained by the Company for the account of others	174,861
Remittances and items not allocated	58,741
Provision for reinsurance	3,680,166
Drafts outstanding	683,244
Payable to parent, subsidiaries, and affiliates	4,768,076
Payable for securities	6,563,747
Aggregate write-ins for liabilities	<u>774,732</u>
Total Liabilities	\$ 155,319,476
Surplus and other funds:	
Partnership Capital Commitment	6,991,257
Unassigned funds (surplus)	<u>611,591,968</u>
Surplus as regards policyholders	\$ 618,583,225
TOTAL	\$773,902,701

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.**

**ALFA MUTUAL FIRE INSURANCE COMPANY
SUMMARY OF OPERATIONS**

For the Years Ended December 31, 2006, 2005, 2004, 2003 and 2002

	2006	2005	2004	2003	2002
Underwriting Income					
Premiums earned	\$152,504,773	\$137,465,125	\$147,118,614	\$149,349,224	130,624,311
Losses incurred	111,768,227	191,046,886	191,400,203	103,777,200	88,522,487
Loss expenses incurred	6,069,774	6,632,356	4,334,071	3,841,895	3,858,946
Other underwriting expenses incurred	53,175,374	34,111,570	48,263,517	51,461,517	44,855,486
Aggregate write-ins for underwriting deductions	<u>(253)</u>	<u>(41,652)</u>	<u>(146,253)</u>	<u>76,752</u>	<u>(266,665)</u>
Total underwriting deductions	<u>171,013,122</u>	<u>231,749,160</u>	<u>243,851,538</u>	<u>159,157,364</u>	<u>136,970,254</u>
Net underwriting gain / (loss)	(18,508,349)	(94,284,035)	(96,732,924)	(9,808,140)	(6,345,943)
Investment Income					
Net investment income earned	34,168,929	40,800,342	37,301,281	34,206,212	47,307,935
Net realized capital gains / (loss)	<u>15,917,850</u>	<u>7,145,309</u>	<u>13,878,867</u>	<u>1,240,488</u>	<u>(11,953,943)</u>
Net investment gain / (loss)	50,086,779	47,945,651	51,180,148	35,446,700	35,353,992
Other Income					
Net gain / (loss) from agents' or premium balances charged off	(266,717)	(47,969)	(45,277)	0	0
Finance and service charges not included in premiums	2,835,712	2,021,091	1,223,452	1,183,432	1,129,587
Aggregate write-ins for miscellaneous income	<u>331</u>	<u>0</u>	<u>0</u>	<u>199</u>	<u>0</u>
Total other income	2,569,326	1,973,122	1,178,175	1,183,631	1,129,587
Net income after dividends to policyholders, after capital gains tax and before all federal and foreign income tax	<u>34,147,756</u>	<u>(44,365,262)</u>	<u>(44,374,601)</u>	26,822,191	<u>30,137,637</u>
Federal and foreign income taxes incurred	<u>(5,770,022)</u>	<u>(5,441,457)</u>	<u>(22,148,178)</u>	<u>5,086,190</u>	<u>7,355,836</u>
Net Income	\$39,917,778	\$(38,923,805)	\$(22,226,423)	\$21,736,001	\$22,781,801

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.**

**ALFA MUTUAL FIRE INSURANCE COMPANY
CAPITAL AND SURPLUS ACCOUNT**

For the Years Ended December 31, 2006, 2005, 2004, 2003 and 2002

	2006	2005	2004	2003	2002
Surplus as regards policyholders, December 31 prior year	\$590,063,198	\$608,756,139	\$624,851,042	\$584,853,295	\$563,473,580
Net income	39,917,777	(38,923,805)	(22,226,423)	21,736,001	22,781,801
Change in net unrealized capital gains Or (losses)	2,566,069	2,568,421	4,639,264	23,028,834	(6,855,718)
Change in net deferred income tax	(8,894,569)	18,392,877	2,515,956	(4,401,299)	5,592,791
Change in non-admitted assets	(120,926)	(1,295,981)	(458,153)	(366,098)	(761,585)
Change in provision for reinsurance	(3,680,166)	565,547	(565,547)	0	0
Cumulative effect of changes in accounting principles	(1,268,158)	0	0	0	552,684
Aggregate write-ins for gains and losses in surplus	<u>0</u>	<u>0</u>	<u>0</u>	<u>309</u>	<u>69,742</u>
Change in surplus as regards policyholders for the year	<u>28,520,027</u>	<u>(18,692,941)</u>	<u>(16,094,903)</u>	<u>39,997,747</u>	<u>21,379,715</u>
Surplus as regards policyholders, December 31 current year	<u>618,583,225</u>	<u>590,063,198</u>	<u>608,756,139</u>	<u>624,851,042</u>	<u>584,853,295</u>

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.**

NOTES TO FINANCIAL STATEMENTS

Note 1 – Properties held for the production income

\$12,287,840

The above captioned amount is the same as that reported by the Company in its 2006 Annual Statement.

The Company provided an appraisal dated December 31, 2004 for the property reported in Schedule A - Part 1, held for the production of income. A review of the appraisal indicated that the appraiser did not certify that the appraisal conformed to ALA. ADMIN. CODE 482-1-059; it also contained the following limiting condition:

“The appraiser will not be required to give testimony or appear in court because of having made this appraisal, with reference to the property in question, unless arrangements have been previously made thereof.”

Neither of which comply with ALA. ADMIN. CODE 482-1-059-.04 (2005), which states:

“The appraiser shall certify that he is familiar with the provisions of this chapter and that the appraisal is made in conformity with the chapter. He shall also certify that he is willing to testify under oath on request concerning the appraisal.”

Note 2 – Uncollected Premiums and agents’ balances in the course of collection

\$28,473,409

Deferred premiums, agents’ balances and

installments booked but deferred and not yet due

\$14,316,911

The captioned \$28,473,409 is the same as reported by the Company in its 2006 Annual Statement, but \$818,674 less than that determined by the examination. The captioned \$14,316,911 is the same as reported by the Company in its 2006 annual Statement, but \$818,674 more than that determined by the examination.

The examination determined that the Company recorded certain premiums due under *Deferred premiums, agents’ balances and installments booked but deferred and not yet due*.

Premiums due are recorded under *Uncollected premiums and agents’ balances in the course of collection*, in accordance with the guidance provided by the NAIC Annual Statement Instructions, which state:

“Line 13.1 – Uncollected premiums and Agents’ Balances in Course of Collection.

Include: Direct and group billed uncollected premiums. Amounts collected but not yet remitted to home office.”

CONTINGENT LIABILITIES AND PENDING LITIGATION

The examination for contingent liabilities and pending litigation included review of the Company’s Annual Statement disclosures, minutes of the corporate governing bodies, pending claims, and the usual examination of the accounts for unrecorded items. No unreported contingent liabilities were noted and all litigation pending against the Company, at December 31, 2006, appeared to be within the ordinary course of its business.

The Company’s Chief Executive Officer and its Chief Financial Officer executed a letter of representation, attesting to the non-existence of unreported liabilities and contingencies as of December 31, 2006.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regards to the Company’s compliance with recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with the recommendations contained in the immediately preceding Report on Examination.

COMMENTS AND RECOMMENDATIONS

Conflict of Interest – Page 7

It is recommended that the Company maintain evidence of its conflict of interest statements signed by each officer, director and other key personnel as required by the Company’s “Principles of Business Conduct” policy and the GENERAL INTERROGATORIES of the NAIC Annual Statement Instructions.

Monthly Billing Service Agreement – Page 12

It is recommended that the Company file all related parties' contracts with the commissioner for approval before entering into transactions under the contract and comply with ALA. CODE § 27-29-5 (b) (1975), which states:

“The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. . . .

(4) All management agreements, service contracts, and all cost-sharing arrangements; and. . . .”

Section 1033 of Title 18 of the U.S. CODE – Page 14

It is recommended that the Company create a policy that ensures those authorized to act on its behalf continue to meet the requirements of Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which states:

“ . . . Insurance companies, as well as persons employing anyone to conduct the business of insurance may be in violation of this statute if they willfully permit participation by a prohibited person, including persons who are already employed or being considered for employment. Failure to initiate a screening process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statute has occurred. . . .”

Claims Payments Practices – Page 18

It is recommended that the Company maintain complete records of closed claims, including the six missing files, in accordance with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and

systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

It is recommended that the Company maintain complete records of the denied and closed without payment claims, including the missing files, in accordance with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

It is recommended that the Company maintains adequate records of the denied and closed without payment claims and retain copies of the denial letter in each file, including the six files determined to lack adequate documentation, as required by ALA. ADMIN. CODE 482-1-125-.07 (2003), which states:

“... No insurer shall deny a first party claim on the grounds of a specific policy provision, condition or exclusion unless reference to such provision, condition, or exclusion is included in the denial. The denial may be given to the first party claimant in writing, verbally or electronically (e-mail). If verbal, the file should clearly indicate the denial and reasons for the denial. If the denial is in writing or electronic (e-mail), the file should contain a copy of the denial letter or e-mail. . . .”

Policyholders’ Complaints – Page 20

It is recommended that the Company record all written communication primarily expressing a grievance in the company’s complaint register. The recommendation is effective May 7, 2007, when the Alabama Department of Insurance adopted the NAIC Market Regulation Handbook.

It is recommended that the company log the function and reasons for complaints in its complaint register. The recommendation is effective May 7, 2007, when the Alabama Department of Insurance adopted the NAIC Market Regulation Handbook.

Accounts and Records – Page 28

It is recommended that the Company maintain the required supporting documentation for all disbursements exceeding \$25.00, including intercompany balance transfers, in accordance with ALA. CODE § 27-27-30 (1975), which states:

“(a) No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money.

(b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. . . .”

Record Retention Policy – Page 30

It is recommended that the Company’s record retention policy indicate that all records should be maintained for no less than five years in accordance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer . . . or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer’s financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

Real Estate: Properties held for the production of income – Page 37

It is recommended that the Company obtain an appraisal in compliance with ALA. ADMIN. CODE 482-1-059-.04 (2005), which states:

“The appraiser shall certify that he is familiar with the provisions of this chapter and that the appraisal is made in conformity with the chapter. He shall also certify that he is willing to testify under oath on request concerning the appraisal.”

Uncollected premiums and agents' balances in the course of collection – Page 37

Deferred Premiums, agents' balances and installments booked but deferred and not yet due – Page 37

It is recommended that the Company record all due and uncollected premiums on *Uncollected premiums and agents' balances in the course of collection* in accordance with the guidance provided by the NAIC Annual Statement Instructions, which state:

“Line 13.1 – Uncollected premiums and Agents' Balances in Course of Collection.

Include: Direct and group billed uncollected premiums. Amounts collected but not yet remitted to home office.”

SUBSEQUENT EVENTS

The review of events subsequent to December 31, 2006, and up to the date of this report included: review of the March 31, 2007, June 30, 2007, and September 30, 2007, Quarterly Statements; 2) review of the December 31, 2007 Annual Statement; and 3) general review of the cash disbursements/receipts transactions that might potentially have a material impact on the Company's continued operations and/or financial conditions. In addition, the examiners inquired of management regarding any significant subsequent events. There were no significant subsequent events other than those discussed below.

Privatization of Alfa Corporation

On April 15, 2008, Alfa Mutual Insurance Company (AMI) and Alfa Mutual Fire Insurance Company (AMF) completed a merger transaction (the Merger) in which they acquired the shares of Alfa Corporation (AC) not previously owned by them. As a result of the transaction, AC became a wholly owned subsidiary of AMI (65%) and AMF (35%). Each share of common stock of AC (other than shares owned by AMI, AMF, AC, and its wholly owned subsidiaries, and holders of shares subject to certain company awards) was cancelled and converted into the right to receive \$22.00 in cash, without interest.

Also, as a result of the Merger, AC's common stock ceased to trade on the Nasdaq Global Select Market as of the close of trading on April 15, 2008, and the registration

of AC's common stock under the Securities Exchange Act of 1934, as amended, was terminated.

Contingencies

Subsequent to the end of the second quarter 2007, and following the initial announcement of the proposed Merger, certain purported class action lawsuits were brought on behalf of the public stockholders of AC in the Delaware Court of Chancery and in the Circuit Court of Montgomery County, Alabama. On April 14, 2008, the Circuit Court of Montgomery County, Alabama, formally approved the settlement reached by the parties to the aforementioned class action lawsuits.

In addition, on November 9, 2007, a policyholder of AMI filed a purported class action against AMI in the Circuit Court of Macon County, Alabama, also relating to the Merger. The policyholder subsequently elected to dismiss the class action claims. Also, on November 21, 2007, certain policyholders of AMI, AMF, and AMG filed a purported class action and derivative action against AMI, AMF, AMG, AC, and certain of their officers and directors in the Circuit Court of Walker County, Alabama. On February 23, 2008, counsel for the parties in the Walker County action entered into a Memorandum of Understanding to settle such action, subject to approval of the court. On March 4, 2008, the Walker County court conditionally approved the settlement and set a final approval hearing for May 28, 2008.

Pooling Agreement

On January 1, 2007, the pooling agreement was amended to add Alfa Alliance Insurance Corporation (AAI). Effective April 16, 2008, the pooling agreement was amended to change the pool participation percentages.

CONCLUSION

In concluding this Report on Examination, as of December 31, 2006, of *ALFA MUTUAL FIRE INSURANCE COMPANY*, acknowledgment is hereby made of the courtesy and cooperation extended by all persons representing the Company during the course of the examination.

The customary examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Charles Turner, Toni Bean, Jennifer Haskell, Mora Perkins, Theo Goodin, Jerry Hyche, Examiners, Frank Fricks, CFE, AIE, with Insurance Logic and Matthew Merlino, FCAS, MAAA, FCA and Suejeudi Buehler, FCAS, MAAA, Consulting Actuarial Examiners, both with Merlinos & Associates, Inc.; all representing the Alabama Department of Insurance, participated in this examination of Alfa Mutual Fire Insurance Company.

Respectfully submitted,

Francis Blase Abreo

Blase Francis Abreo, CFE
Examiner-in-Charge
State of Alabama
Department of Insurance